

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
)	
)	CC Docket No. 96-45
Federal-State Joint Board on Universal Service)	
)	FCC 04J-2
)	
)	

To: Federal-State Joint Board on Universal Service

**REPLY COMMENTS OF THE INDEPENDENT TELEPHONE AND
TELECOMMUNICATIONS ALLIANCE**

The Independent Telephone and Telecommunications Alliance (“ITTA”), through its attorneys, hereby offers the following Reply Comments in the above-referenced proceeding.¹

I. INTRODUCTION AND SUMMARY

The universal service high-cost fund has been an unqualified success in bringing affordable, quality telecommunications services to rural areas that would not otherwise be possible. To ensure that rural communities continue to receive telecommunications services that are comparable to urban areas, the Joint Board should recommend that the Federal Communications Commission (“FCC”) retain its current criteria for determining if an incumbent local exchange carrier (“ILEC”) is eligible for rural high-cost support. Rural ILECs should continue to receive support at the study area level, based on the ILEC’s historic embedded costs. Similarly, competitive eligible telecommunications carriers (“CETCs”) should receive support based on their own actual costs, not the costs of the ILEC. ITTA further urges that the Joint

¹ *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission’s Rules Relating to High-Cost Universal Service Support*, Public Notice in CC Docket 96-45, FCC 04J-2 (rel. Aug. 16, 2004).

Board advocate that the FCC revise its rules governing support for expenditures in newly acquired exchanges to encourage carriers to make much needed investment in such exchanges.

II. THE JOINT BOARD SHOULD RECOMMEND RETAINING THE CURRENT CRITERIA FOR DETERMINING RURAL UNIVERSAL SUPPORT ELIGIBILITY AND FOR CALCULATING RURAL SUPPORT

A. The FCC Needs to Set Clear Directives On LEC Cost Recovery Before Considering New Methods for Calculating Support

The record in this proceeding demonstrates that rural carriers currently are facing extraordinary regulatory uncertainty, and favors retaining the current rural high-cost fund eligibility criteria for rural ILECs and the communities they serve. In addition to competitive pressures in many rural markets, rural carriers rely far more heavily on access charges and universal service support than carriers in urban markets, and thus are particularly vulnerable to changes to these compensation mechanisms. Of particular relevance to the issues being considered by the Joint Board, the Commission currently has before it major changes to intercarrier compensation and the ETC designation process. At the Joint Board's public hearing held on November 17, 2004, several commenters stressed the need to settle the issues raised in these proceedings prior to changing the basis of ILEC support.² Joel Lubin of AT&T explained:

[how these issues are resolved] will affect how you answer the questions that are before [the Joint Board] today. It could in fact eliminate the need for the questions to be answered or, clearly, if they still need to be answered, the way in which you solve it would . . . be fundamentally different.³

² Federal Communications Commission, Public Meeting on High-Cost Universal Service Support for Areas Served by Rural Carriers and Related Issues, November 17, 2004 at 42 (testimony of Joel Lubin), 55 (testimony of Dale Lehman), 101 (testimony of Jeffrey Reynolds) ("Transcript").

³ Transcript at 42.

As such, it would not be prudent to make changes to the criteria for determining rural ILEC support eligibility in advance of the FCC's findings in the above-discussed major reform initiatives.

B. Departing From Current Definition of "Rural Telephone Company" Would Harm Rural Communities and Provide No Apparent Countervailing Benefits

The record in this proceeding does not justify making major changes to the rural ILECs' basis of support. The Joint Board should not recommend altering the rural high cost fund in a way that would jeopardize support to rural communities, with no countervailing benefits to universal service. Although several commenters suggest different thresholds for determining which carriers will qualify for "rural" support, no commenter provides a sufficient reason to override the use of Congress's own definition of "rural telephone company" in the Communications Act of 1934, as amended (the "Act"). The Act's definition of "rural" properly accounts for the differences between rural and non-rural carriers as well as the diversity among rural carriers themselves.

The Joint Board should recommend that the FCC continue to calculate support at the study-area level and not aggregate study areas at the holding company or state-wide level. Jeffrey Reynolds described in his testimony to the Joint Board on behalf of ITTA, "Changing eligibility criteria for universal service high-cost support . . . likely would strip many rural communities of their support based simply on the fact that they are served by a carrier that is part of a larger holding company structure."⁴ Adoption of such a proposal would require carriers either to reintroduce implicit subsidies, contrary to the goals of Section 254 of the Act,⁵ or

⁴ Prepared Testimony of Jeffrey Reynolds on Behalf of ITTA, CC Docket No. 96-45, at 2 (filed Nov. 9, 2004).

⁵ 47 U.S.C. § 254(e).

simply raise rates in the highest-cost areas by an amount necessary to recover costs – which likely would cause rates to become unaffordable.⁶

C. A Reliable Forward-Looking Cost Model Does Not Exist

The record in this proceeding also indicates that the Joint Board should recommend retaining use of historic costs to calculate rural ILEC support. Suggestions that historic costs are inefficient ignore the considerable review to which rural carrier costs are subject. ILEC historic costs are heavily scrutinized by regulators to ensure that expenditures made were in the public interest and properly should be included in the rate base. The purpose of universal service is to compensate carriers-of-last-resort for costs they prudently incurred to serve high-cost areas and cannot be recovered through affordable rates. Thus, to the extent that a forward-looking cost model would result in a lower cost estimate, it would do so only because such a model departs from the real costs of running the ILEC's network, based on prudent past investment decisions. Such cost-model results would not reflect real cost savings, but rather would result in insufficient support, in violation of Section 254 of the Act.

As Dr. Dale Lehman observed (discussing savings that might come from using a forward-looking cost model for switching):

The problem is that today's embedded switching costs reflect efficient investment decisions in the past. Unless it can be shown that deployment of the switches currently in use was inefficient at the time these were installed, failure to permit cost recovery of these switches presents only illusory cost savings.⁷

⁶ Prepared Testimony of Jeffrey Reynolds on Behalf of ITTA, CC Docket No. 96-45, at 7-8 (filed Nov. 9, 2004).

⁷ Written Statement of Dale Lehman, Docket No. 96-45, presented Nov. 17, 2004 [emphasis in original].

Comments and testimony before the Joint Board further demonstrate that a forward-looking cost model is inherently inappropriate for rural carriers. Due to a rural carrier's smaller customer base, any anomalies or inaccuracies of a forward-looking cost model will be magnified. Such models fail in the face of the substantial variability between rural and non-rural carriers, not to mention diversity among the approximately 1300 rural ILECs.⁸ Mr. Reynolds testified:

The embedded-cost mechanism is the most precise method for determining network cost. The differences between rural and non-rural carriers make it problematic to apply a forward-looking high cost support mechanism to rural carriers. The distortions caused by . . . forward-looking cost models are far less in the more homogeneous non-rural areas. The dislocations that have been demonstrated in rural areas by using a forward-looking model would produce disastrous decreases in funding for rural areas.⁹

ITTA urges the Joint Board to heed these warnings and recommend continued use of embedded costs, as they are the most accurate means to determine the appropriate level of rural carrier support. The inaccuracies inherent in forward-looking cost models make such models the least "efficient" method of determining distribution of universal service funds.

D. The Joint Board Must Give Primary Importance to the Universal Service Principles of Section 254 of the Act

Collectively or individually, the proposed changes to the rural ILEC basis of support fall short of upholding the universal service mandates of the Act.¹⁰ Proponents of departing from use of the statutory definition of "rural telephone company" for determining rural high-cost fund eligibility or of moving away from basing support on actual embedded costs do

⁸ Transcript at 89.

⁹ *Id.* at 40.

¹⁰ *See, e.g.*, 47 U.S.C. §§ 254(b)(1)-(3), (5); *see also id.* § 254(e) (requiring that support be "explicit").

not offer reasons that would advance the universal service goals of the Act. Rather, they cite goals, such as “efficiency” and “competition,” that may be found elsewhere in the Act, but are unrelated to the universal service principles set forth in Section 254 of the Act. Court precedent demonstrates, however, that it is beyond the authority of the FCC to substitute such goals for the mandated universal service principles in Section 254(b).¹¹ “[T]he FCC may exercise its discretion to balance the principles against one another when they conflict, but may not depart from them altogether to achieve some other goal.”¹² Section 254(b)’s mandates that support should be specific, predictable and sufficient, and that service to rural areas be comparable to service to non-rural areas must not be compromised for these other policy goals.

III. CETCS SHOULD JUSTIFY RECEIPT OF UNIVERSAL SERVICE SUPPORT BASED ON THEIR OWN COSTS

CETCs should receive funding based on their own actual costs. Funding CETCs based on ILEC costs fails to provide even the most basic means of ensuring accountability for use of universal service support. In contrast, requiring CETCs to justify their costs will provide the FCC with the requisite tools of accountability to ensure that support to CETCs is being properly distributed and utilized, in conformance with Section 254(e) of the Act. Various commenters have supported the use of the CETCs’ actual costs for assessing levels of support for CETCs.¹³ NASUCA summarized the issue as follows:

Under the current system, where CETCs receive support based on the ILEC’s costs, it is theoretically possible for a CETC to collect

¹¹ *Qwest Corporation v. FCC*, 258 F.3d 1191, 1200 (10th Cir. 2001).

¹² *Id.*

¹³ *See, e.g.*, Comments of National Association of State Utility Consumer Advocates (“NASUCA”) at 33-34; Fairpoint Communications at 18-19; Comments of the Organization for the Promotion and Advancement of Small Telephone Companies (“OPASTCO”) at 12-18; Comments of the Rural Independent Competitive Alliance at 2-4; Comments of the National Telecommunications Cooperative Association at 7-9.

public support even if it earns super-normal profits or already has abundant incentives to expand its network in any given designated service territory. . . . This lack of connection between CETC costs and support represents a fundamental flaw in the current framework. Providing support to competitors who have not demonstrated any need for support does not enhance the public interest and fails to ensure that public funds are being used for any purpose consistent with 47 U.S.C. 254.¹⁴

It is *not* competitively neutral to provide CETCs support identical to the ILEC's per-line support.

To the contrary, providing support with such little scrutiny of the CETCs' use of support compared to ILECs' use of support is competitively non-neutral. As Gene Johnson of Fairpoint Communications explained in his written testimony, "[T]here is nothing competitively neutral about requiring rural ILECs to provide extensive data demonstrating above-average costs in order to qualify for support, while not requiring competitors to provide any cost justification for their own receipt of support."¹⁵

ITTA requests that the Joint Board recommend a method or methods of assessing CETC costs to the FCC that minimize the accounting burden on CETCs, while still accomplishing the goal of accurately and fairly assessing their costs. As David Cole described in his testimony on behalf of ITTA, wireless carriers can easily track and report their costs. Mr. Cole, speaking from his experience working with CenturyTel's prior wireless businesses and as a former member of the CTIA finance committee, stated:

¹⁴ Comments of NASUCA at 34.

¹⁵ Statement of Gene Johnson, Fairpoint Communications, Inc. at 4 (Nov. 17, 2004) [emphasis in original]; *see also* Separate Statement of Commissioner Kathleen Q. Abernathy, *In the Matter of 2000 Biennial Regulatory Review – Comprehensive Review of Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2, Amendments to the Uniform System of Accounts for Interconnection, Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, Local Competition and Broadband Reporting*, 16 FCC Rcd 19911 (2001) ("Requiring incumbent LECs, but no one else, to comply with costly regulations to open their books to competitors raises obvious questions of competitive neutrality").

there is some pretty standard accounting methodology that would not make [reporting costs] an impossible task. . . . Independent telcos and others have a separate set of accounting records, even for their specific areas So, I do think it's possible and I do think there is some consistency. And I do think an analysis of costs would be possible.¹⁶

Additionally, wireless carriers use standard accounting as a means to accurately report valuations to financial markets. The Joint Board should recommend that CETCs report their costs in order for the state and federal regulatory bodies to determine the appropriate level of support for each CETC. Ultimately, the principle of competitive neutrality demands that all eligible carriers receive support based on their own, actual costs.

IV. THE SAFETY VALVE MECHANISM SHOULD BE AMENDED TO PROMOTE, NOT DISCOURAGE, IMPROVED SERVICES TO ACQUIRED EXCHANGES

ITTA reiterates its support for eliminating the disincentives to invest in newly acquired exchanges during the first year after acquisition. ITTA advocates eliminating Section 54.305(a), which limits per-line support to the amount for which the selling carrier was eligible, and modifying Section 54.305(d), the “safety valve” mechanism. These rules discourage investment in exchanges in which the seller typically has devoted few resources in the years leading up to acquisition. Carriers should be eligible for support immediately following acquisition of the exchange to encourage expenditures in the first year of operation, when it is most needed. Carriers make investments in these exchanges in the first year after acquisition, but it appears that such investments are made *despite* the safety-valve mechanism.¹⁷ The Joint Board should recommend changes to the FCC’s rules so that the safety-valve encourages rapid

¹⁶ Transcript at 194.

¹⁷ Comments of ITTA at 30-31.

investment in rural exchanges, rather than delay the benefits that rural consumers anticipate from these acquisitions.

V. CONCLUSION

For the foregoing reasons, the Joint Board should recommend that the FCC continue to determine eligibility for rural high-cost support using the definition of “rural telephone company” set forth in the Act, and to calculate support based on a rural carrier’s history embedded costs. The Joint Board also should recommend that CETCs also justify their support based on CETCs’ own actual costs. Additionally, ITTA requests that the Joint Board advocate that the FCC encourage investment in newly acquired exchanges by revising Section 54.305 of its rules.

Respectfully submitted,
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